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Investing in Cannabis: Inconsistent Government Regulation and Constraints on Capital

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INVESTING IN CANNABIS: INCONSISTENT GOVERNMENT REGULATION AND CONSTRAINTS ON CAPITAL

By Adrian A. Ohmer*

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I. INTRODUCTION

Cannabis¹ “is America’s most valuable [cash crop], worth an estimated \$35 billion, more than hay, soybeans, and corn[.]”² and has enormous potential value not only for businesses, but also for state and federal governments via tax revenue.³ However, since 1970, the government has spent \$1 trillion on the War on Drugs.⁴ Even though President Obama’s administration declared the War on Drugs over in 2009,⁵ his drug interdiction

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1. The word “cannabis” is used throughout the note, as opposed to “marijuana” or “pot,” because it is the scientific name for the plant. However, in order to maintain the integrity of the sources referenced, the original wording of those sources have been preserved when quoted.

2. GREG CAMPBELL, POT, INC.: INSIDE MEDICAL MARIJUANA, AMERICA’S MOST OUTLAW INDUSTRY xxiii (2012).

3. There is an argument that legalizing and taxing cannabis may not generate enough revenue to cover greater social costs, including increased health care, lost work productivity, crime, and other expenditures. *See id.* at 188. It is claimed that total illicit drug use already accounts for \$180 billion in social costs, noting that alcohol and tobacco don’t generate enough revenue to offset their social costs. *See id.*

4. *Id.* at xxii.

5. *See* Gary Fields, *White House Czar Calls for End to ‘War on Drugs’*, WALL ST. J. (May 14, 2009, 12:01 AM), <http://online.wsj.com/news/articles/SB124225891527617397?mg=reno64-wsj&url=http%3A%2F%2Fonline.wsj.com%2Farticle%2FSB124225891527617397.html>.

budget request for FY 2011 was still \$15.55 billion,⁶ a 3.5 percent increase from FY 2010⁷ and a (nominal) 17.1 percent increase from FY 2008.⁸ Indeed, \$10 billion was earmarked for law enforcement.⁹ Furthermore, it is estimated that the United States spends “\$13.7 billion per year enforcing marijuana laws alone, the total price of both state and federal expenditures on interdiction efforts and the cost of incarceration.”¹⁰

Despite the federal government’s stance on cannabis, and the current and historical spending to wage the War on Drugs, recent polls and legislation suggest that sentiment among American voters has shifted in favor of legalization.¹¹ One of the most significant recent developments in the history of drug regulation and prohibition in the United States occurred on November 6, 2012, when voters in Washington and Colorado voted to legalize the possession, production, and recreational use of cannabis.¹² On the same day, Connecticut and Massachusetts voted to become the 17th and 18th states, respectively, to join the club of states that allow cannabis for medical purposes.¹³ Additionally, in October 2013, California announced that it would form a panel headed by the Lieutenant Governor to draft a possible 2016 ballot measure to legalize cannabis in the state.¹⁴ All of these developments at the state level fly in the face of the federal government, which has declared cannabis to be of no medical or other legal

6. EXEC. OFFICE OF THE PRESIDENT, NATIONAL DRUG CONTROL STRATEGY: FY 2011 BUDGET SUMMARY 15 (2010) [hereinafter FY2011 BUDGET STRATEGY], available at <http://www.whitehouse.gov/sites/default/files/ondcp/policy-and-research/fy11budget.pdf>.

7. *Id.*

8. See EXEC. OFFICE OF PRESIDENT, NATIONAL DRUG CONTROL STRATEGY: FY 2010 BUDGET SUMMARY 13 (2009), available at <http://www.whitehouse.gov/sites/default/files/ondcp/policy-and-research/fy10budget.pdf>. Of note, however, is that the drug control budget in both 2008 and 2011 is lower—in nominal and real terms—than in 2000. See OFFICE OF NAT’L DRUG CONTROL POLICY, NATIONAL DRUG CONTROL STRATEGY: FY 2001 BUDGET SUMMARY 2 (2000), available at <https://www.ncjrs.gov/ondcppubs/publications/policy/budget00/budget2000.pdf> (estimating the FY 2000 drug control budget at \$18.45 billion (\$24.29 billion in 2012 dollars)).

9. FY2011 BUDGET STRATEGY, *supra* note 6, at 15.

10. See CAMPBELL, *supra* note 2, at 109.

11. See, e.g., *CNN Poll: Support for Legal Marijuana Soaring*, CNN (Jan. 6, 2014, 8:00 PM), <http://politicalticker.blogs.cnn.com/2014/01/06/cnn-poll-support-for-legal-marijuana-soaring/>.

12. Ella Peterson, *Marijuana Legalization: Colorado and Washington State Grapple with Implementing New Laws*, POLICYMIC (Jan. 10, 2013) <http://www.policymic.com/articles/22459/marijuana-legalization-colorado-and-washington-state-grapple-with-implementing-new-laws>.

13. See *infra* note 46.

14. See Eliza Gray, *New Laws Chart Course for Marijuana Legalization*, TIME (Oct. 19, 2013), <http://nation.time.com/2013/10/19/new-laws-chart-course-for-marijuana-legalization/>; Joe Garofoli, *Newsom, ACLU Look to Legalize Marijuana*, S.F. CHRON. (Oct. 17, 2013, 11:21 PM), <http://www.sfgate.com/politics/joegarofoli/article/Newsom-ACLU-look-to-legalize-marijuana-4904985.php>.

use and placed the crop on the most restrictive list of illegal substances, accompanied by drugs like heroin and MDMA.¹⁵

This note's focus is on the future of investing in the growing legalized cannabis industry. In Part II, it will provide a brief history of federal and state regulation of cannabis. Part III will discuss the current role of the federal government in regulating the cannabis industry. Part IV will explore the current avenues of access to capital for the cannabis industry. Lastly, Part V will provide suggestions for the federal government and state governments to reduce investment risk that exists in the cannabis industry.

II. BRIEF HISTORY OF REGULATING CANNABIS

While the history of drug policy is well-documented and researched, a brief discussion is necessary here, given the country's complex and highly political history of cannabis regulation. The idea of regulating cannabis was first introduced in the United States via the 1937 Marihuana Tax Act.¹⁶ The Act did not seek to make cannabis illegal, only to "burden anyone hoping to touch it with an onerous tax and a complicated system of requirements that made it so difficult to comply that it was effectively banned"¹⁷ It easily became law after now-incredible testimony and evidence was produced during congressional hearings at the direction of Harry J. Anslinger, who was the Commissioner of the Federal Narcotics Bureau from 1930-1961 (a predecessor to the Drug Enforcement Administration), after having served as a federal assistant Prohibition commissioner.¹⁸

While a corporate conspiracy theory is often cited as the reason why cannabis was first brought under federal regulation, a more plausible catalyst for regulating cannabis is simply racism.¹⁹ Steven Wishnia explains, "[f]rom the 19th-century campaigns against opium and alcohol to the crack panic of the 1980s, they have all been fueled by racism and cultural war, conflated with fear of crime and occasionally abetted by well-intentioned reform impulses."²⁰ Opium and cocaine regulation, via the Harrison Narcotics Act of 1914,²¹ can be traced to anti-Chinese and anti-black sentiments in the United States, whereas prohibition "found momentum in anti-immigrant sentiments aimed at Poles, Jews, Germans, Irish, and Italians in the urban centers and blacks in the south."²² Richard Nixon

15. 21 U.S.C. § 812 (2012).

16. CAMPBELL, *supra* note 2, at 51.

17. *Id.* at 57.

18. *See id.* at 51-58; *see also* Steven Wishnia, *Debunking the Hemp Conspiracy Theory*, ALTERNET (Feb. 20, 2008), http://www.alternet.org/story/77339/debunking_the_hemp_conspiracy_theory.

19. CAMPBELL, *supra* note 2, at 59-60; *see also* Wishnia, *supra* note 18.

20. Wishnia, *supra* note 18.

21. Harrison Acts, ch. 1, 38 Stat. 785 (1914).

22. CAMPBELL, *supra* note 2, at 62.

elevated the fear of cannabis and drugs more generally throughout his administration. The secret tape recorders in the Oval Office captured Nixon once saying:

An awful lot of nations have been destroyed by drugs . . . I have seen the countries of Asia and the Middle East, portions of Latin America, and I have seen what drugs have done to those countries. Everybody knows what it's done to the Chinese, the Indians are hopeless anyway, the Burmese. They have different forms of drugs . . . Why the hell are those Communists so hard on drugs? Well, why they're so hard on drugs is because they love to booze. I mean, the Russians, they drink pretty good. But they don't allow any drugs. And look at the north countries. The Swedes drink too much, the Finns drink too much, the British have always been heavy boozers and . . . the Irish of course the most. But on the other hand, they survive as strong races . . . And your drug societies inevitably come apart.²³

Nixon's goal to not let the United States become a "drug society" that would "inevitably come apart" was accomplished (legislatively, at least) when Congress passed the Comprehensive Drug Abuse Prevention and Control Act in 1970²⁴ ("the Act"). The Act includes the Controlled Substances Act (CSA) (Title II), which sets up the scheduling classifications.²⁵ All controlled substances are placed into one of five schedules on the basis of "their potential for abuse, accepted medical use, and a lack of accepted safety," with Schedule I controlled substances deemed to have the highest potential for abuse, no accredited medical use, and a lack of accepted safety, decreasing down to Schedule V.²⁶ Cannabis is classified as a Schedule I narcotic, along with heroin, GHB, MDMA, LSD, and other hard drugs.²⁷

By including pot in this dubious crowd, the U.S. government sent a clear message to a nation of potheads at a time when the White House was feeling besieged by them: Marijuana is sinister and evil with no redeeming qualities whatsoever. Those who use it run the risk of becoming hopelessly hooked, reduced to scrapping ashtrays for loose shake or wayward resin as they chase a high that threatens to lead them to worse substances. Putting a drug in the Schedule I classification is like putting an inmate in the high-security solitary-confinement wing of the federal penitentiary, a place to sock away from society the most incorrigible creatures humankind or nature has cursed us with. From the federal government's point of view, cocaine and opium are less harmful than marijuana—they are Schedule II drugs, defined as having "a currently accepted medical use in treatment in the United States."²⁸

The Act also set up an administrative process to add, delete, or change the schedule of a drug, which can be initiated by the Drug Enforcement

23. *Id.* at 64-65.

24. Comprehensive Drug Abuse Prevention and Control Act of 1970, Pub. L. No. 91-513, 84 Stat. 1236 (codified as amended at 21 U.S.C. §§ 801-971 (2012)).

25. 21 U.S.C. § 812 (2012).

26. *Id.*

27. *Id.*

28. CAMPBELL, *supra* note 2, at 65.

Agency (DEA), the Department of Health and Human Services (HHS), or by petition from any interested party.²⁹ In May 1972, the National Organization for the Reform of Marijuana Laws (NORML) and other groups submitted a petition to the DEA to remove cannabis from Schedule I and free the crop of all controls entirely, or to transfer it from Schedule I to Schedule V, where it would be subject to only minimal controls.³⁰ On September 6, 1988, after 16 years of administrative law hearings, federal court hearings, and negotiations between the DEA and the various pro-cannabis groups,³¹ Administrative Law Judge Francis L. Young issued a decision on administrative rulemaking, pursuant to the Administrative Procedure Act.³² He ruled on the principal issue of “whether the marijuana plant, considered as a whole, may lawfully be transferred from Schedule I to Schedule II of the schedules established by the Controlled Substances Act” and on two subsidiary issues, “[w]hether the marijuana plant has a currently accepted medical use in treatment in the United States, or a currently accepted medical use with severe restrictions” and “[w]hether there is a lack of accepted safety for use of the marijuana plant under medical supervision.”³³ Young analyzed the medical use of cannabis in chemotherapy, glaucoma, multiple sclerosis, spasticity, and hyperparathyroidism in great depth. Regarding chemotherapy, Young made 38 findings of fact and noted that the medical community broadly accepted medical use of marijuana:

From the foregoing uncontroverted facts it is clear beyond any question that many people find marijuana to have, in the words of the Act, an “accepted medical use in treatment in the United States” in effecting relief for cancer patients. Oncologists, physicians treating cancer patients, accept this. Other medical practitioners and researchers accept this. Medical faculty professors accept it. Nurses performing hands-on patient care accept it. Patients accept it.³⁴

Indeed, Young concluded:

The overwhelming preponderance of the evidence in this record establishes that marijuana has a currently accepted medical use in treatment in the United States for nausea and vomiting resulting from chemotherapy treatments in some cancer patients. To conclude otherwise, on this record, would be unreasonable, arbitrary, and capricious.³⁵

Regarding multiple sclerosis, spasticity, and hyperparathyroidism, Young made 50 findings of fact and a determination that, as with chemotherapy,

29. 21 U.S.C. § 814.

30. Marijuana Rescheduling Petition, Dep’t of Justice, Drug Enforcement Admin., No. 86-22 (Sep. 6, 1988) [hereinafter *Marijuana Rescheduling Petition*] (opinion and recommended ruling of administrative law judge).

31. *Id.* at 6.

32. Pub. L. No. 79-404, 60 Stat. 237 (1946) (codified as amended in scattered sections of 5 U.S.C.).

33. Marijuana Rescheduling Petition, *supra* note 30, at 7.

34. *Id.* at 26.

35. *Id.* at 34.

it would be unreasonable, arbitrary, and capricious to find against its accepted medical use.³⁶ With respect to glaucoma, however, Young did not find sufficient evidence of the same weight.³⁷

Young also analyzed the safety of cannabis, using aspirin, a commonly used over-the-counter product, as a basis for comparison. He found that twenty times the recommended dose of aspirin may cause lethal reaction and will almost certainly cause gross injury to the digestive system;³⁸ in fact, aspirin causes hundreds of deaths each year.³⁹ Contrasted against aspirin is cannabis, for which Young found “no record in the extensive medical literature describing a proven, documented cannabis-induced fatality[,]”⁴⁰ and, in order to induce death from cannabis, a smoker “would theoretically have to consume nearly 1,500 pounds of marijuana within about fifteen minutes to induce a lethal response.”⁴¹ He went on to analyze the lethal and toxic qualities of then-approved medicines for cancer and the side effects from these drugs as compared to cannabis, concluding that “the provisions of the Act permit and require the transfer of marijuana from Schedule I to Schedule II.”⁴² Ultimately, the power to move cannabis from Schedule I to Schedule II was in the hands of DEA Administrator John C. Lawn, who instead chose to overrule the Administrative Law Judge’s decision.⁴³ Lawn’s decision and the analytical framework used, which his successor affirmed on remand,⁴⁴ was ultimately affirmed by the D.C. Circuit Court of Appeals in 1994, when the court denied the private parties’ petition for review.⁴⁵

While cannabis remains illegal at the federal level, states have acted as progressive laboratories regarding cannabis regulation. Currently, 18 states have legalized cannabis for medical purposes, including (in chronological order): California (1996); Oregon (1998); Alaska (1998); Washington (1998); Maine (1999); Hawaii (2000); Colorado (2000); Nevada (2000); Vermont (2004); Montana (2004); Rhode Island (2006); New Mexico (2007); Michigan (2008); Arizona (2010); New Jersey (2010); Delaware

36. *Id.* at 54.

37. *Id.* at 38.

38. *Id.* at 58.

39. Marijuana Rescheduling Petition, *supra* note 30, at 57.

40. *Id.* at 56.

41. *Id.* at 57.

42. *Id.* at 67.

43. See Marijuana Scheduling Petition; Denial of Petition, 54 Fed. Reg. 53,767, 53,783 (Dep’t of Justice, Drug Enforcement Admin., Dec. 29, 1989) (“The Administrator rejects the administrative law judge’s findings and conclusions. They were erroneous; they were not based upon credible evidence; nor were they based upon evidence in the record as a whole. Therefore, in this case, they carry no weight and do not represent the position of the agency or its Administrator.”).

44. See Marijuana Scheduling Petition; Denial of Petition; Remand, 57 Fed. Reg. 10,499, 10,507-08 (Dep’t of Justice, Drug Enforcement Admin., Mar. 26, 1992).

45. *Alliance for Cannabis Therapeutics v. Drug Enforcement Admin.*, 15 F.3d 1131, 1137 (D.C. Cir. 1994).

(2011); Connecticut (2012); and, Massachusetts (2012).⁴⁶ Although voters originally approved a medical cannabis program in 1998,⁴⁷ the District of Columbia (D.C.) did not pass its own medical cannabis law until 2010, the 12-year delay stemming from Congress' attachment of riders to the D.C. appropriations act⁴⁸ that blocked the act from taking effect until 2010.⁴⁹ Once effective, D.C. drafted legislation to create a medical cannabis program, which the mayor signed into law. After a 30-day Congressional review period, during which neither the Senate nor the House acted to stop the law, the program was established.⁵⁰

All of these states have removed state-level criminal penalties for the cultivation, possession, and use of cannabis, where a medical doctor has recommended such use; moreover, all have instituted programs to regulate the use of medical cannabis by approved patients.⁵¹ Physicians in those states are immune from liability and prosecution for discussions or recommendations of medical cannabis to their patients, and patients may be assisted by caregivers (except in New Mexico and New Jersey), who are authorized to help patients grow, acquire, and use cannabis.⁵² Regarding the then 14—now 18—states with medical cannabis programs, Mark Eddy explains:

Effective state medical marijuana laws do not attempt to overturn or otherwise violate federal laws that prohibit doctors from writing prescriptions for marijuana and pharmacies from distributing it. In the 14 states with medical marijuana programs, doctors do not actually prescribe marijuana, doctors *recommend* marijuana to their patients, and the cannabis products are grown by patients or their caregivers, or they are obtained from cooperatives or other alternative dispensaries. The state medical marijuana programs do, however,

46. CAL. HEALTH & SAFETY CODE § 11362.5; OR. REV. STAT. §§ 475.300-.375; ALASKA STAT. ANN. § 17.37.010; WASH. REV. CODE ANN. §§ 69.51A.005 - .903; ME. REV. STAT. ANN. tit. 22, § 2383-B; HAW. REV. STAT. §§ 329-121 to -128; COLO. CONST. art. 18, § 14; NEV. REV. STAT. ANN. §§ 453A.010 - .810; VT. STAT. ANN. tit. 18, §§ 4472-41; MONT. CODE ANN. §§ 50-46-101 to -344; R.I. GEN. LAWS ANN. §§ 21-28.6-1 to -13; N.M. STAT. ANN. §§ 26-2B-1 to -7; MICH. COMP. LAWS ANN. §§ 333.26421-.26430; ARIZONA REV. STAT. §§ 36-2801-36-2819; N.J. STAT. ANN. § 24:6I-1; 16 DEL. C. CH. 49A; CONN. H.B. 5389 (draft regulations released on Jan. 16, 2013); MASS. BALLOT QUESTION 3. Additionally, Maryland allows for a medical necessity defense for people who use cannabis on their own for medical purposes, but does not have a medical cannabis program. MD. CRIM. CODE ANN. §5-601; *see also* MARK EDDY, CONG. RESEARCH. SERV. RL33211, MEDICAL MARIJUANA: REVIEW AND ANALYSIS OF FEDERAL AND STATE POLICIES 23 (2010)).

47. *See Election Results, Initiative Measure #59*, D.C. BD. OF ELECTIONS AND ETHICS, http://www.dcooe.org/election_info/election_results/elec_1998/ini59_98.htm (last updated Sept. 20, 1999).

48. *See Consolidated Appropriations Act, 2010*, Pub. L. No. 111-117, 123 Stat. 3034 (2009).

49. D.C. CODE § 7-1671 (see miscellaneous notes); *see also* EDDY, *supra* note 46, at 24-25.

50. *20 Legal Medical Marijuana States and DC*, PROCON.ORG, <http://medicalmarijuana.procon.org/view.resource.php?resourceID=000881> (last updated Dec. 13, 2013).

51. EDDY, *supra* note 46, at 18.

52. *Id.*

contravene the federal prohibition of marijuana. Medical marijuana patients, their caregivers, and other marijuana providers can, therefore, be arrested by federal law enforcement agents, and they can be prosecuted under federal law.⁵³

On November 6, 2012, however, two states went even further than the state medical cannabis programs discussed above. Voters in Colorado and Washington approved ballot initiatives that:

not only made it lawful for adults to use and possess up to an ounce of marijuana—for any purpose, not just medical—but also ordered state regulators to begin licensing commercial businesses to engage in for-profit cultivation and distribution of the drug, much as those regulators currently do with tobacco and alcohol.⁵⁴

The initiatives in both states framed their efforts through the lens of making the most efficient use of law enforcement resources, public health and safety, and generating new tax revenue for the state.⁵⁵

III. ROLE OF THE FEDERAL GOVERNMENT

Before discussing the role of the private sector in and financing of the cannabis industry, it is important to understand the role of the federal government in this burgeoning industry. Constitutionally, it would seem that those state laws that allow for a cannabis industry to exist (whether for medical or recreational purposes) would be pre-empted by federal law banning such allowance due to the Supremacy Clause.⁵⁶ However, it has not been as simple in practice, “[leading] to a seemingly incongruous situation in which both the federal criminal prohibition on marijuana and state medical marijuana exemptions coexist.”⁵⁷ As discussed in Part II, the Controlled Substances Act is the federal law that categorizes all drugs (via schedules) and has outlawed the use of cannabis.⁵⁸ Furthermore, in 2005, the United States Supreme Court upheld Congress’s power to prohibit even purely intrastate cultivation and possession of marijuana.⁵⁹ But significant questions were left open for those in states where cannabis had been legalized under state law. To aid United States attorneys with such questions, Deputy Attorney General David W. Ogden released a memo-

53. *Id.* at 19.

54. Roger Parloff, *Yes We Cannabis*, FORTUNE, Apr. 8, 2013, at 68.

55. In Colorado, the initiative was known as Amendment 64: The Regulate Marijuana Like Alcohol Act of 2012, available at <http://www.regulatemarijuana.org/s/regulate-marijuana-alcohol-act-2012>. In Washington, the initiative was known as Initiative Measure No. 502, available at http://sos.wa.gov/_assets/elections/initiatives/i502.pdf.

56. U.S. CONST. art. VI, cl. 2 (“The Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land.”).

57. TODD GARVEY, CONG. RESEARCH. SERV. R42398, MEDICAL MARIJUANA: THE SUPREMACY CLAUSE, FEDERALISM, AND THE INTERPLAY BETWEEN STATE AND FEDERAL LAWS 1 (2012).

58. See *supra* text accompanying notes 24-28.

59. GARVEY, *supra* note 57, at 5 (citing *Gonzalez v. Raich*, 545 U.S. 1 (2005)).

randum in October 2009.⁶⁰ In that memorandum, Ogden attempted to clarify that the pursuit of illegal drug manufacturing and trafficking (namely, Mexican cartel operations) “should not focus federal resources . . . on individuals whose actions are in clear and unambiguous compliance with existing state laws providing for the medical use of marijuana.”⁶¹ While that seemingly took care of the conflict between federal and state laws (in that, if one was in compliance with state law, then there existed no federal priority to enforce), the Ogden Memorandum was also clear that the federal government would continue to investigate and prosecute commercial enterprises in the cannabis industry and that “claims of compliance with state or local law may mask operations inconsistent with the terms, conditions, or purposes of those laws, and federal law enforcement should not be deterred by such assertions”⁶²

Due to incomplete readings of the Ogden Memorandum, there was a significant increase in commercial cultivation, sale, distribution, and use of cannabis for purported medical purposes.⁶³ The Department of Justice was forced to clarify the Ogden Memorandum in June 2011, when Deputy Attorney General Juan M. Cole released another memo clarifying that it is within Congress’s power to prohibit the production, possession, and distribution of marijuana and within the federal government’s power to exercise that authority, through the Department of Justice and the DEA. The memo reads, in part:

The Ogden Memorandum was never intended to shield such activities from federal enforcement action and prosecution, even where those activities purport to comply with state law. Persons who are in the business of cultivating, selling or distributing marijuana, and those who knowingly facilitate such activities, are in violation of the Controlled Substances Act regardless of state law. Consistent with resource constraints and the discretion you may exercise in your district, such persons are subject to federal enforcement action, including potential prosecution. State laws and ordinances are not a defense to civil or criminal enforcement of federal law with respect to such conduct, including enforcement of the CSA. Those who engage in transactions involving the proceeds of such activity may also be in violation of federal money laundering statutes and other federal financial laws.⁶⁴

Though the federal government is prohibited under the Constitution from commandeering state legislatures or state executive officials by mandating

60. Memorandum from David W. Ogden, Deputy Att’y Gen., U.S. Dep’t of Justice, for selected U.S. Att’ys (Oct. 19, 2009) [hereinafter Ogden Memo], available at <http://www.justice.gov/opa/documents/medical-marijuana.pdf>.

61. *Id.*

62. *Id.*

63. GARVEY, *supra* note 57, at 3.

64. Memorandum from James M. Cole, Deputy Att’y Gen., U.S. Dep’t of Justice, for all U.S. Att’ys, Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Medical Use (June 29, 2011) [hereinafter Cole Memo], available at <http://www.justice.gov/oip/docs/dag-guidance-2011-for-medical-marijuana-use.pdf>.

that states enact legislation or implement or enforce federal law,⁶⁵ Congress can persuade states to follow federal policy by conditioning the receipt of federal funds upon state enactment of certain legislation.⁶⁶

The power of the federal government with respect to the burgeoning cannabis industry is not limited to the courts, the Department of Justice, and the DEA. Other pertinent areas of the federal government are the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS). The mission of the SEC is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation[.]”⁶⁷ the mission of the IRS is to help taxpayers understand their tax responsibilities and to enforce the tax laws.⁶⁸

The SEC comes into play when considering investment funds seeking investors and wishing to invest their funds in companies such as those producing and selling cannabis. Generally speaking, investment funds may have to file paperwork with the SEC to ensure compliance with the federal securities laws. As part of the Dodd-Frank Act, the previously-available private adviser exemption from registering with the SEC was eliminated, requiring many fund advisors who were formerly exempt to then register. The SEC has since adopted rules creating certain new exemptions, including the Private Fund Adviser Exemption (those with less than \$150 million of assets under management),⁶⁹ Venture Capital Fund Adviser Exemption (those that only advise venture capital funds),⁷⁰ and Mid-Sized Advisers Rule (between \$25 million and \$100 million of assets under management and required to register as an investment adviser in the state of principal office).⁷¹ Likewise, any company that wishes to build a significant investor base or access the public markets will also, absent exemptions, have to file disclosures with the SEC.⁷² These disclosures to the SEC must be truthful,

65. GARVEY, *supra* note 57, at 7.

66. *Id.*

67. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC. EXCH. COMM'N (Aug. 23, 2013, 4:45 PM), <http://www.sec.gov/about/whatwedo.shtml>.

68. *The Agency, its Mission and Statutory Authority*, INTERNAL REVENUE SERV., <http://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority> (last updated Mar. 26, 2013).

69. See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39,646, 39,666-74 (July 6, 2011) (to be codified at 17 C.F.R. pt. 275).

70. See *id.* 39,648-66.

71. See Rules Implementing Amendments to the Investment Advisers Act of 1940, 76 Fed. Reg. 42,950, 42,951-54 (July 19, 2011) (to be codified at 17 C.F.R. pts. 275, 279); see also Timothy Spangler, *Deadline for Hedge Fund, Private Equity Fund Managers to Register with SEC Rapidly Approaching*, FORBES (Feb. 8, 2012, 3:29 PM), <http://www.forbes.com/sites/timothyspangler/2012/02/08/deadline-for-hedge-fund-private-equity-fund-managers-to-register-with-sec-rapidly-approaching/>.

72. See Securities Exchange Act of 1934 § 12g, 15 U.S.C. § 78l (2012) (limiting companies to less than 2,000 investors, or 500 who are not accredited investors, before having to register with the SEC, as recently amended by the JOBS Act); Exchange Act §15d, *id.* § 78o

or else the funds and owners of the funds are exposed to the potential of civil and/or criminal actions by the SEC.⁷³ Perhaps due to past inability to set up cannabis investment funds (prior to November 2012, the recreational cannabis market did not exist), the SEC has yet to issue any guidance or no-action letters to such funds on which they may base their actions.⁷⁴

Investment funds and the companies in which they invest are also required, per the IRS, to declare or otherwise account for all income made in the yearly tax collection.⁷⁵ Therefore, any personal or business conduct that affects securities or tax obligations has significant federal implications, even if a person or business entity maintains all of its business or earnings within one state. Unlike the SEC, the IRS has issued guidance with regards to taxing medical cannabis companies and the tax benefits those companies are permitted to take. Members of the House of Representatives that represent districts where medical cannabis is legal have asked the IRS for guidance on the tax treatment that businesses in the industry might receive. The IRS has responded, stating:

Section 280E of the [Internal Revenue Code] disallows deductions incurred in the trade or business of trafficking in controlled substances that federal law or the law of any state in which the taxpayer conducts the business prohibits. For this purpose, the term “controlled substances” has the meaning provided in the Controlled Substances Act. Marijuana falls within the Controlled Substances Act. The United States Supreme Court has concluded that no exception in the Controlled Substances Act exists for marijuana that is medically necessary. Because neither section 280E nor the Controlled Substances Act makes exception for medically necessary marijuana, we lack the authority to publish the guidance that you request. The result you seek would require the Congress to amend either the Internal Revenue Code or the Controlled Substances Act.⁷⁶

Section 280E specifically denies a tax deduction or credit for any expense in a business consisting of trafficking in illegal drugs, thus prohibiting businesses in the cannabis industry from deducting their business expenses, as other businesses do.⁷⁷

(requiring issuers to provide supplementary and periodic information to their registration statement); *see also* STEPHEN J. CHOI & A.C. PRITCHARD, *SECURITIES REGULATION: CASES AND ANALYSIS* 391-466 (3d ed. 2012).

73. *See generally* CHOI & PRITCHARD, *supra* note 72, at 168-206.

74. As of March 1, 2014, after formal checks on SEC websites and in-depth web searches.

75. *See generally* INTERNAL REVENUE SERV., *TAX GUIDE FOR SMALL BUSINESS*, PUBL’N 334, at 11 (2012), *available at* <http://www.irs.gov/pub/irs-prior/p334—2012.pdf> (“You must figure your taxable income and file an income tax return for an annual accounting period called a tax year. Also, you must consistently use an accounting method that clearly shows your income and expenses for the tax year.”).

76. Letter from Andrew J. Keyso, Deputy Assoc. Chief Counsel, U.S. Dep’t of the Treasury, to Sam Farr, Congressman, U.S. House of Representatives (Dec. 16, 2010) [hereinafter Keyso Letter], *available at* <http://www.irs.gov/pub/irs-wd/11-0005.pdf>.

77. 26 U.S.C. § 280E (2012).

IV. CURRENT STATE OF CANNABIS INDUSTRY: RISKS AND ACCESS TO CAPITAL

Given the history and the restrictive role of the federal government regarding the cannabis industry, it may seem too risky to invest in the industry. Yet, businesses and investors are developing business plans and building their financing sources despite the overlay of federal risk that permeates every aspect of the cannabis industry, and the national press is increasingly covering these developments.⁷⁸ Advances in the private sector will likely originate in those states that have decriminalized cannabis (currently Colorado and Washington), and the developments to-date show this to be the case. This section will analyze the risks associated with the cannabis industry and three recent trends in the cannabis investment space.

A. Overall Industry Risks

1. Government Action (Federal and Local)

The cannabis industry presents a significant problem to the investment industry in a number of ways. First, the risk remains for any player in the cannabis industry that the federal government may shut down the business and/or impose civil or criminal liability. While some degree of risk is normally accepted and modeled by investors into their investment decisions, these would pose significant additional risks for an investment firm to accept. The risks are increased if the business merely touches cannabis, and is especially so if it actually possesses or distributes the substance, as the Ogden and Cole Memoranda both make clear.⁷⁹ This is due to the Racketeer Influenced and Corrupt Organizations (RICO) Act of 1970 and later expanded as part of the Comprehensive Crime Control Act in 1984.⁸⁰ These laws aim to deny “drug kingpins and organized crime bosses of the spoils of their ill-gotten gains” and divide any assets collected from busts among “the Justice Department, the Treasury Department, and the local cops who aided in the seizure in the first place.”⁸¹ Therefore, not only may fines and prison terms ensue from participation in the cannabis industry, but also potentially the loss of one’s property. Police need only probable cause to seize one’s car, cash, and even one’s home, if suspected that they were used in the commission of a drug crime.⁸²

Interestingly, liability may not be limited just to investors and business owners, as “[i]t is not only individuals who possess, produce, or distribute [cannabis] who are subject to federal sanctions, but also those who con-

78. See generally Parloff, *supra* note 54.

79. Ogden Memo, *supra* note 60; Cole Memo, *supra* note 64.

80. 18 U.S.C. §§ 1961-68 (2012).

81. CAMPBELL, *supra* note 2, at 66.

82. See 18 U.S.C. § 981(b); see also U.S. DEP’T OF JUSTICE, ASSET FORFEITURE POLICY MANUAL 17 (2007), available at <http://www.justice.gov/criminal/foia/docs/policy07.pdf>; CAMPBELL, *supra* note 2, at 66.

spire, aid, abet, or assist in that proscribed conduct.”⁸³ This liability may thus extend to state actors that enable the cannabis industry as well, and U.S. Attorneys have expressly stated as much.⁸⁴ Tripp Keber, President and CEO of Red Dice Holdings, which specializes in the edibles and elixirs segment of the cannabis industry, better explains:

If you lock me up, then you should head down to the marijuana enforcement division and lock all those people up . . . [a]nd then from there, let’s go down to the mayor’s office, because the mayor’s the one who sells me my license, which is \$15,000 a year. But then, lastly, Gov. (John) Hickenlooper, who . . . certified the election, basically put the law into effect. So if you were going to arrest me as a trafficker of contraband, then these are all my accessories to the crime. And the reality is, that’s not likely to happen.⁸⁵

And it may not be solely the federal government who tries to come after these businesses: municipalities may, too, try to rid their communities of the industry. One tactic used to accomplish this is to close businesses that are in violation of a municipality’s land use code, which prohibits activities that are against federal law.⁸⁶ The city of Centennial, Colorado has done just this, using the violation of a land use code as the legal basis for shutting down medical cannabis dispensaries.⁸⁷ The judge who ruled on the suit agreed that the dispensary was in violation of both federal law and the land use code, but held that it was not the city’s job to enforce federal law, concluding instead that “the city of Centennial cannot use the potential violation of a federal law to order a business legally operating under [Colorado] state constitution to cease and desist its business.”⁸⁸ While this is a win for businesses operating in the industry, there still exists significant litigation risk, the cost of which will be borne in large part by those business’ investors.

83. GARVEY, *supra* note 57, at 14 (citing 21 U.S.C. § 846, which makes it illegal to conspire to violate the CSA); 18 U.S.C. §§ 2-4, 371.

84. Letter from Jenny A. Durkan, U.S. Att’y, W.D. Wa., and Michael C. Ormsby, U.S. Att’y, E.D. Wa., to the Hon. Christine Gregoire, Washington State Governor (Apr. 14, 2011) (“[W]e maintain the authority to enforce the [Controlled Substances Act] vigorously against individuals and organizations that participate in unlawful manufacturing and distribution activity involving marijuana, even if such activities are permitted under state law.”); *see also* GARVEY, *supra* note 57, at 14-15.

85. Kent Bernhard, Jr., *Can Private Equity and Pot Mix? Brendan Kennedy Thinks So*, UPSTART BUS. J. (Mar. 21, 2013, 10:28 AM), <http://upstart.bizjournals.com/money/loot/2013/03/21/can-private-equity-and-pot-mix.html?page=all>.

86. *See* Verified Complaint and Application for Injunctive And Declaratory Relief at 8-16, *Frasher v. City of Centennial*, No. 09-cv-1456 (Colo. D. Ct., Arapahoe Cnty, Nov. 30, 2009), *available at* <http://www.cannabistherapyinstitute.com/legal/centennial/centennial.com.plaint1.pdf>; *see also* CAMPBELL, *supra* note 2, at 194.

87. CAMPBELL, *supra* note 2, at 194.

88. John Ingold, *Judge Rules Centennial Closed Pot Shop Illegally*, DENVER POST (Dec. 30, 2009, 12:52 PM), http://www.denverpost.com/ci_14094504.

2. Intellectual Property Protection

Federal laws also impede businesses in the cannabis industry from building brand names for themselves and their products.⁸⁹ Robert Mikos discusses the role of trademark law in the cannabis industry, explaining:

To register a trademark, the owner must demonstrate actual use in commerce or bona fide intent to use. The use in commerce requirement poses two problems for [cannabis] distributors. First, courts and the Patent and Trademark Office (“PTO”) have interpreted it to mean *lawful* use in commerce, making it impossible to satisfy as long as marijuana distribution remains illegal under federal law. Second, in any event, a [business] would admit to a federal crime—in a federal court no less—by attesting to having sold marijuana in commerce. Such an admission could expose the owner to federal crime and civil sanctions. The PTO recently considered recognizing trademarks on medicinal [cannabis], but it quickly abandoned the idea.⁹⁰

Similar impediments exist for common law trademark⁹¹ and state trademark registration.⁹²

Regarding patents and copyrights, it seems that federal law may actually provide some protection for the cannabis industry. In contrast to trademarks, in order to obtain a patent, an inventor need not currently use, have ever used, or ever plan to use an invention to file and receive patent protection on that invention. So long as the patent is written broadly enough to encompass a legitimate purpose or substance, the fact that the invention’s use is illegal does not seem to prevent it from being patented.⁹³ Copyright protection attaches as soon as something is reduced to writing, drawing, or physical form; therefore, a federal copyright registration can be obtained for creative expression that relates to something illegal, so long as the requisite actions have taken place.⁹⁴

3. Access to Banking Institutions

Access to banking and the services that banks provide, while possible, is not as readily available for members of the cannabis industry as for others. Federal regulations do not specifically prohibit banks from having accounts related to the cannabis industry and otherwise doing business

89. Robert A. Mikos, *State Taxation of Marijuana Distribution and Other Federal Crimes*, 2010 U. CHI. LEGAL F. 223, 257 (2010).

90. *Id.* at n.126 (citations omitted).

91. *Id.* at n.127.

92. *Id.* at n.128.

93. See generally *What Can Be Patented*, U.S. PAT. & TRADEMARK OFF. (Nov. 2011), http://www.uspto.gov/patents/resources/general_info_concerning_patents.jsp#heading-4 (last visited Nov. 18, 2013); see also Thomas W. Galvani, *Can I Patent Something that is Used for an Illegal Purpose?*, GALVANI LEGAL (Mar. 16, 2012), <http://www.galvanilegal.com/can-i-patent-something-that-is-used-for-an-illegal-purpose>.

94. U.S. COPYRIGHT OFF., COPYRIGHT BASICS 2 (2012), available at <http://www.copyright.gov/circs/circ01.pdf>.

with the legalized cannabis industry.⁹⁵ Furthermore, Attorney General Holder told Congress in December 2011 that the Department of Justice would not make it a priority to pursue financial institutions that worked with the legal medical-cannabis industry,⁹⁶ despite the fact that the Cole Memorandum included a warning that “those who engage in transactions involving the proceeds of [the cannabis industry] may . . . be in violation of federal money laundering statutes and other federal financial laws.”⁹⁷ Despite these instances of relative leniency in connection with the cannabis industry, financial institutions that are federally licensed or insured must still comply with federal regulations. And, since cannabis is illegal under federal law, those financial institutions refuse to hold accounts for legal cannabis-related businesses for fear of prosecution.⁹⁸ In October 2011, the last bank in Colorado that openly worked with the medical-cannabis industry officially closed down the accounts associated with dispensaries, forcing the industry to operate on a mostly cash-only basis.⁹⁹ While operating on a cash-only basis does not prohibit a business from operating, it is inconvenient and “makes it hard to act like a legitimate business.”¹⁰⁰ In Washington, medical-cannabis businesses have met the same inconveniences. One bank has stated that its core concern revolves around the unknown risks in the industry and that, since the accounts associated with the cannabis industry involve large cash deposits, such involvement necessitates heightened scrutiny and reporting under federal banking and money-laundering laws.¹⁰¹

Responding to many of these issues, the Department of Justice released a memorandum on February 14, 2014, regarding marijuana-related financial crimes.¹⁰² The Department intended to make clear that, “if a financial institution or individual offers services to a marijuana-related business whose activities do not implicate any of the eight priority factors [in the August 29 memo¹⁰³], prosecution for these offenses may not be appro-

95. Jonathan Martin, *Medical-Marijuana Dispensaries Run Into Trouble at the Bank*, SEATTLE TIMES (Apr. 29, 2012), http://seattletimes.com/html/localnews/2018103547_maribanking30m.html.

96. *Id.*

97. Cole Memo, *supra* note 64.

98. STATE OF COLO. TASK FORCE REPORT ON THE IMPLEMENTATION OF AMENDMENT 64, REGULATION OF MARIJUANA IN COLORADO 98 (2013) [hereinafter COLO. TASK FORCE REPORT], available at <http://www.colorado.gov/cms/forms/dor-tax/A64TaskForceFinalReport.pdf>.

99. John Ingold, *Last Bank Shuts Doors on Colorado Pot Dispensaries*, DENVER POST (Oct. 1, 2011), http://www.denverpost.com/news/marijuana/ci_19016660.

100. *Id.*

101. Martin, *supra* note 95.

102. Memorandum from James M. Cole, Deputy Att’y Gen., U.S. Dep’t of Justice, for all U.S. Att’y’s, Guidance Regarding Marijuana Related Financial Crimes (Feb. 14, 2014) [hereinafter Financial Crimes Memo], available at <http://www.dfi.wa.gov/banks/pdf/dept-of-justice-memo.pdf>.

103. See *infra* Part V.B for discussion on eight priority factors.

priate.”¹⁰⁴ While this guidance may be perceived by some as giving a preliminary “green light” for the establishment of relationships between banking institutions and legal cannabis businesses, the Colorado Bankers Association believes that the guidance is actually a “red light.”¹⁰⁵ The Association stated that the memorandum “outlined ‘all the risks involved of banking the marijuana industry’ and ‘made it very clear that financial institutions can still face criminal liability.’”¹⁰⁶ Indeed, the financial services offered would still have to comply with state regulatory schemes, and the institutions and individuals making such services available would have to “continue to apply appropriate risk-based anti-money laundering policies, procedures, and controls sufficient to address the risks posed by [marijuana-related businesses], including by conducting customer due diligence designed to identify conduct that relates to the eight priority factors.”¹⁰⁷ In its assessment of the recent memorandum, the Washington Bankers Association similarly noted that guidance memorandums can change at any time and do not supersede the federal law.¹⁰⁸

4. Tax Treatment

Lastly, cannabis-focused businesses may not be permitted to take advantage of classic business deductions on their taxes.¹⁰⁹ Functionally this means that those businesses that actually touch the plant are effectively taxed on their gross revenues, as opposed to their gross profits. Of course, only investing in those businesses that do not possess, distribute, or touch the cannabis plant can mitigate this particular risk, but the scope of how the IRS may interpret any illegal income gains is presently unknown and leaves that risk both open-ended and impossible to prepare for.

B. Cannabis Investment Today

Given the risks discussed in Part IV.A, it may be hard to imagine any capital flow into the legalized cannabis industry. Overall, funding is scarce in this industry, particularly in light of the potential market size. Part IV.B of this note will analyze three capital sources for the legalized cannabis industry today.

1. Formal Fund Investing

Traditionally, developing businesses and technologies receive their first significant infusion of financing in the form of private equity, usually pro-

104. Financial Crimes Memo, *supra* note 102, at 2-3.

105. Herb Weisbaum, *Banks Balk on Marijuana Money Despite US Guidelines*, CNBC (Feb. 21, 2014, 8:05 AM), <http://www.cnbc.com/id/101433431>.

106. *Id.*

107. Financial Crimes Memo, *supra* note 102, at 3.

108. *Id.*

109. See Keyso Letter, *supra* note 76; see also *supra* Part III.

vided by a venture capital fund.¹¹⁰ Venture capital funds typically take equity stakes in startups (small and medium sized businesses) with strong growth potential.¹¹¹ The benefits of venture financing are numerous:

[They] often . . . provide the funds needed to finance research and development and growth in multiple rounds of financing. Many . . . work closely with young companies and can assist with formulating business strategy, recruiting additional management talent, assembling a board of directors, . . . providing introductions in the financial community . . . [and] mak[ing] the company more profitable than the founders alone could have made it.¹¹²

Venture capital funds are commonly structured as limited partnerships, where the general partner serves as the decision-maker with respect to investments and management of portfolio companies, the venture fund employees are housed in the management company, and the investors (whether institutions or individuals) comprise the limited partners in the fund.¹¹³ The advantage of this model stems from the traditional allocation of management fees and profits, and the tax treatment of those allocations.¹¹⁴

Given that this brand of private equity seeks to make strategic investments in burgeoning industries with significant return potential, it would seem that the cannabis industry would be a promising area with a lot of venture financing activity. However, due to the risks discussed, the financing activity is actually quite low, with only a few known funds focused in this space.¹¹⁵ One such fund is Privateer Holdings, a private equity firm whose investments are focused in the legal cannabis field and which closed a \$7 million fund in July 2013.¹¹⁶ In a recent *Forbes* article, one of Privateer's founders, Brendan Kennedy, explained that the traditional venture capital firm route does not work (at least presently) for the cannabis in-

110. See generally CONSTANCE E. BAGLEY & CRAIG E. DAUCHY, *THE ENTREPRENEUR'S GUIDE TO BUSINESS LAW* 458 (4th ed. 2011). The term "private equity" is used in its broader sense, of which venture capital is a subset.

111. *Venture Capital Funds*, INVESTOPEDIA, <http://www.investopedia.com/terms/v/vc-fund.asp> (last visited Nov. 18, 2013).

112. BAGLEY & DAUCHY, *supra* note 110, at 149.

113. See generally Asher Bearman, *How VC Funds Work—Structure Chart for Venture Capital Fund (US Fund)*, VENTURE ALLEY BLOG (Feb. 27, 2011), <http://www.theventurealley.com/how-funds-work/how-vc-funds-work—typical-fund-structure/>.

114. See generally *id.*; see also Asher Bearman, *How VC Funds Work—Expenses and Management Fees*, VENTURE ALLEY BLOG (Jan. 12, 2011), <http://www.theventurealley.com/vc-and-pe-funds/how-vc-funds-work—expenses-and-management-fees/>.

115. Ariel Schwartz, *Pay Close Attention To This Marijuana Millionaire's Weed Venture Capital Fund*, FAST CO. EXIST (Jan. 27, 2014, 9:20 AM), <http://www.fastcoexist.com/3025170/pay-close-attention-to-this-marijuana-millionaires-weed-venture-capital-fund> (listing Emerald Ocean Capital, the ArcView Angel Investor Network, and the High Times Growth Fund as some of the players in the cannabis investment space).

116. *Privateer Holdings—The Cannabis Industry's First Private Equity Firm—Closes \$7 Million Funding Round*, WALL ST. J. MARKET WATCH (July 16, 2013, 6:00 AM), <http://www.marketwatch.com/story/privateer-holdings-the-cannabis-industrys-first-private-equity-firm-closes-7-million-funding-round-2013-07-16>.

dustry for two reasons: first, the model leaves partners vulnerable to legal liability; and, second, the industry lacks the kind of quality, professional business owners that a venture fund traditionally finances and “leave[s] alone.”¹¹⁷ For these reasons, Privateer structured itself as a holding company, in the vein of Berkshire Hathaway.¹¹⁸ In contrast to the traditional private equity/venture capital structure, holding companies usually make longer-term investments, as compared with the classic ten-year fund life pervasive in the private equity and venture capital sectors.¹¹⁹

Current discussion about the true value of the holding company structure in the venture capital space, generally, aside,¹²⁰ the most significant takeaway, as pertains to Privateer’s structural decision, is that the firm may have a longer investment horizon than a classic venture fund. And, although it is unknown if or how one structure might mitigate cannabis industry risks better than the other, in Privateer’s case the investment vehicle is sufficiently insulated, because the firm “won’t touch weed itself, but . . . [will focus on the] market for ancillary goods and services[.]” with an estimated market size of \$10 billion a year.¹²¹ The ancillary goods and services market alone may be divided into at least four distinct areas for investing, including “companies marketing to the cultivator (for example, technology for growing), companies marketing to the end consumer . . . , companies marketing to retailers (security, point-of-sale software), and companies with licenses to produce and sell cannabis.”¹²² Even so, the scarcity of private equity players in the cannabis market and the stigma that cannabis currently carries, thereby disincentivizing larger funds from investing in the market,¹²³ renders it is hard to make any real determina-

117. J.J. Colao, *Meet the Yale MBAs Trying to Tame the Marijuana Industry*, FORBES (Mar. 26, 2013, 1:23 PM), <http://www.forbes.com/sites/jjcolao/2013/03/26/meet-the-yale-mbas-trying-to-tame-the-marijuana-industry/>.

118. *Id.* On the Berkshire Hathaway point, some private equity managers have even called Berkshire’s model “the perfect private equity model.” Peter Lattman, *The Private Equity Parallels with Buffet*, N.Y. TIMES DEALBOOK (Apr. 5, 2011, 9:06 AM), <http://dealbook.nytimes.com/2011/04/05/the-private-equity-parallels-with-buffett/>.

119. See Billy Fink, *Are Holding Companies the Future of Private Equity*, AXIAL (Mar. 21, 2013), <http://www.axial.net/blog/are-holding-companies-the-future-of-private-equity/>.

120. See Ronald J. Sylvestri, Jr., *Why the Standard Private Equity Fund is Losing its Luster*, FORBES (Mar. 13, 2013, 8:00 AM), <http://www.forbes.com/sites/realspin/2013/03/13/why-the-standard-private-equity-fund-is-losing-its-luster/>; Fink, *supra* note 119.

121. Wendy Kaufman, *Private Equity Fund Eyes The Business of Pot*, NPR (Aug. 1, 2013, 4:54 PM), <http://www.npr.org/2013/08/01/207899209/private-equity-fund-eyes-the-business-of-pot>.

122. Alice Troung, *The “Yelp of Weed”: Leafly and Other Marijuana Startups Hope to Gain as Feds Ease Up on Pot*, FAST CO. (Oct. 19, 2013, 8:38 AM), <http://www.fastcompany.com/3019855/the-yelp-of-weed-leafly-and-other-marijuana-startups-hope-to-gain-as-feds-ease-up-on-pot>.

123. *Id.* (quoting one of the largest venture capital funds, Kleiner Perkins Caulfield & Byers, stating: “Kleiner Perkins very much cares about its brand. . . . There are tons of opportunities to make money that we don’t invest in because it doesn’t fit with our values. I can’t imagine in the near term that we’d invest in a business that makes it money off marijuana.”) (internal quotations omitted).

tions about the use of a traditional legal setup as opposed to a holding company structure.

2. Angel Investing

Another source of financing for businesses in the cannabis industry is angel investors. Unlike private equity funds, angel investors are private individuals who invest either debt or equity in private businesses as they see fit for their investment profile and often do not seek active roles in the day-to-day business operations (for example, by not insisting on board representation or a right to approve or select key employees).¹²⁴ Furthermore, individual angel investors “usually require no more than the right to veto major changes in the business, restrictions on increases in top management’s salary, and limits on the amount of equity to be available for incentive programs.”¹²⁵ By contrast, angel networks or investor groups typically operate much more like venture capital funds.¹²⁶

One angel network that is developing in this industry is ArcView Angel Network.¹²⁷ ArcView aims “to bridge the gap between would-be financiers of [the cannabis industry]—investors who sometimes know little about [cannabis]—and would-be entrepreneurs in it, who sometimes know little about finance or business.”¹²⁸ Any accredited investor,¹²⁹ whether institutional or individual, who is willing to put at least \$50,000 into opportunities presented by ArcView is permitted to become a member of the network.¹³⁰ ArcView itself does not invest in the businesses that it presents to members, so, in that sense, it does not operate like a venture capital fund, as described above.¹³¹ Instead, ArcView functions as an investment platform, as follows:

Accredited investors pay ArcView to join—currently about \$3,500 per year. (Because of snowballing interest, all fees are constantly being revised upward.) ArcView culls solicitations from entrepreneurs who seek funding for their nascent businesses. Those who make it through this prescreening can pay for the opportunity to make a pitch at one of ArcView’s quarterly meetings. That fee is about \$1,250 to \$3,000, depending on the size of the company. If investors like what they hear, they can strike deals with the entrepreneurs individually or jointly.¹³²

124. BAGLEY & DAUCHY, *supra* note 110, at 147.

125. *Id.*

126. *Id.*

127. THE ARCVIEW GROUP, <http://arcviewgroup.com/> (last visited Nov. 10, 2013).

128. Parloff, *supra* note 54, at 68.

129. 17 C.F.R. § 230.501(a); *see also Accredited Investor Definition*, SEC. EXCH. COMM’N, <http://www.sec.gov/answers/accred.htm> (last visited Nov. 10, 2013).

130. *Investor Network*, ARCVIEW GROUP, <http://arcviewgroup.com/investornetwork/> (last visited Nov. 10, 2013).

131. Parloff, *supra* note 54, at 69.

132. *Id.*

According to ArcView, its investor membership includes heirs to family money, representatives of venture capital funds, and owners of established companies; company membership includes an LED lighting company, an inventory management company, and a portable vaporizer company (amongst others).¹³³ Groups like ArcView may prove to be more beneficial for cannabis-related business investment than traditional fund investment, because the legal liability flows to only one investor (or a few), as opposed to the presumably broader investor base of a fund (its limited partners). This is likely to be especially true for those businesses that require actual physical possession of the plant as a key component of their business model.

3. Crowdfunding

Crowdfunding is yet another alternative cannabis businesses may consider when seeking funds. Crowdfunding itself is a newer method of financing (existing since the late 1990s).¹³⁴ At its most basic level, Crowdfunding involves “using a method of mass communication, typically the Internet, to solicit funds from the community at large, with the project creator receiving small individual amounts of funding from a large number of donors or investors.”¹³⁵ Until recently, all crowdfunding platforms have been modeled as: (1) donation-based (contributors receive nothing in exchange for their funds); (2) rewards-based (contributors receive a token item like a t-shirt or film credit); (3) pre-sale (contributors have option to purchase the product in advance of its availability to the market); or (4) peer-to-peer lending (individuals lend money directly to borrowers).¹³⁶ Sites like Kickstarter, IndieGogo, and Kiva exemplify these crowdfunding models. However, President Obama’s signing of the JOBS Act¹³⁷ into law in April 2012 unleashed another model in the crowdfunding space—equity ownership in a startup company, by which investors may partake in the potential upside (and downside) of that business. Prior to the passage of the JOBS Act, there was no legal way for businesses to offer financial interests in their companies to investors without registering those offerings with the SEC.¹³⁸

133. *Investor Network*, *supra* note 130.

134. *The History of Crowdfunding*, FUNDABLE, <http://www.fundable.com/crowdfunding101/history-of-crowdfunding> (last visited Feb. 25, 2014).

135. Thaya Brook Knight, Huiwen Leo, & Adrian A. Ohmer, *A Very Quiet Revolution: A Primer on Securities Crowdfunding and Title III of the JOBS Act*, 2 MICH. J. OF PRIV. EQUITY & VENTURE CAP. L. 135, 135 (2012); *see also* *Crowdfunding*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/crowdfunding.asp> (last visited Mar. 1, 2014); Mark Koba, *You Hear Lots About Crowdfunding, But What is it?*, CNBC (Oct. 23, 2013, 2:54 PM), <http://www.cnbc.com/id/101136608>.

136. Knight et al., *supra* note 135, at 135-36; *see also* C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 51-67 (2012).

137. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

138. Knight et al., *supra* note 135, at 135-36.

Crowdfunding might seem like the ideal means of financing for the burgeoning cannabis industry to tap, since it offers the potential for millions of individuals to invest in a business. But, if a cannabis-related business is interested in offering an equity interest in the company, crowdfunding is not currently an ideal form of financing for two reasons. First, under the JOBS Act, the SEC is required to promulgate rules pursuant to the terms of the Act before any crowdfunding portal that offers a financial interest may operate. The Act also requires that equity crowdfunding portals be registered with a self-regulatory organization like the Financial Industry Regulatory Authority (FINRA). While the SEC¹³⁹ and FINRA¹⁴⁰ have recently released proposed rules for crowdfunding, the industry for equity crowdfunding is still at bay until regulators fully implement such rules, which is not expected to take place until late spring or early summer of 2014.¹⁴¹ Second, even when equity crowdfunding is live, becoming a viable financing option, there will still be drawbacks to crowdfunding financing stemming from the SEC's role in regulating this space. Companies engaged in equity crowdfunding would need to comply with all of the rules issued by the SEC, including filing with the SEC and providing, at a minimum, annual reports of operations and financial statements to investors.¹⁴² Those companies would then be exposed to potential federal securities law liability.¹⁴³ Furthermore, an equity crowdfunding portal that facilitates these transactions would have to submit itself to an alternative regulatory regime, subject to the SEC and an organization like FINRA.¹⁴⁴ These elements are likely to increase compliance costs for both the business that uses an equity crowdfunding portal and for the equity crowdfunding portal itself.

Currently, there is one crowdfunding platform dedicated to the cannabis industry—WeCanna.com.¹⁴⁵ WeCanna presents itself as a rewards-based crowdfunding site that facilitates the crowdfunding of “legal canna-

139. Crowdfunding, Securities Act Release No. 33-9470, Exchange Act Release No. 34-70741, 78 Fed. Reg. 66,428 (proposed Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200 et seq.)

140. FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 13-34 (2013), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p370743.pdf>; FIN. INDUS. REGULATORY AUTH., REGULATORY NOTICE 12-34 (2012), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p131268.pdf>; see also *Crowdfunding Portals*, FIN. INDUS. REGULATORY AUTH., <http://www.finra.org/Industry/Issues/Crowdfunding/> (last visited Mar. 1, 2014).

141. *Title III of the JOBS Act Underway: Everything You Need to Know*, STARTUP VALLEY (Jan. 21, 2014), www.startupvalley.com/blog/title-iii-of-the-jobs-act-underway-everything-you-need-to-know.htm.

142. See generally *JOBS Act: Growing Momentum*, MORRISON FOERSTER (Mar. 7, 2013), <http://www.mofo.com/files/Uploads/Images/130307-JOBS-Act-Growing-Momentum.pdf>.

143. *Id.*

144. *Id.* at 56.

145. As of today, it does not have any active investment opportunities. WECANNA, <http://www.wecanna.com/> (last visited Nov. 17, 2013).

bis and hemp markets.”¹⁴⁶ The platform also expresses an explicit desire to enter the equity crowdfunding space once the regulatory regime is solidified.¹⁴⁷ Given the substantial regulatory oversight that will accompany equity crowdfunding, WeCanna’s desire may prove incredibly, perhaps prohibitively, expensive and complex.¹⁴⁸

V. SUGGESTIONS TO REDUCE INVESTMENT RISK

A. Congressional Action

The United States Congress is in the most significant position of power to change the risk calculations in the legalized cannabis industry. First and foremost, it can remove cannabis altogether from the Controlled Substances Act. The Ending Federal Marijuana Prohibition Act of 2013 (H.R. 499), which was introduced and sponsored by Congressman Jared Polis of Colorado, aims to do exactly that.¹⁴⁹ Since the bill’s introduction on February 5, 2013, it has gained 16 co-sponsors and been referred to multiple House Committees.¹⁵⁰ Passage of this Act would be the ideal action, as it would direct the Attorney General to issue a final order to remove cannabis from all schedules of controlled substances, eliminate cannabis as a drug in the federal criminal code, and subject cannabis to the same federal regulations as alcohol.¹⁵¹ However, the bill’s chances of becoming law are low,¹⁵² and Congressman Polis attributes this to significant pressure from the “law enforcement industrial complex . . . [and] all those on the gravy train of the drug war[,] which means parts of law enforcement and their private sector vendors.”¹⁵³

As an alternative to outright legalization of cannabis at the federal level, the United States Congress could address and fix the conflicts of law between the federal and state governments as it relates to legalized canna-

146. See WECANNA, <http://wecanna.com/about-wecanna> (last visited Feb. 24, 2014).

147. *Id.*

148. WECANNA, http://www.wecanna.com/cannabis_business_idea/ (“We hope to get there eventually . . .”).

149. Ending Federal Marijuana Prohibition Act of 2013, H.R. 499, 113th Cong. (2013), available at <http://beta.congress.gov/bill/113th-congress/house-bill/499>.

150. See *Committees: H.R.499—113th Congress (2013-2014)*, CONGRESS.GOV, <http://beta.congress.gov/bill/113th/house-bill/499/committees> (last visited Oct. 27, 2013); *Cosponsors: H.R.499—113th Congress (2013-2014)*, CONGRESS.GOV (last visited Oct. 27, 2013).

151. Ending Federal Marijuana Prohibition Act of 2013, H.R. 499, 113th Cong. (2013), available at <http://beta.congress.gov/bill/113th-congress/house-bill/499>.

152. GovTrack.us estimates a 5 percent chance of getting past committee and a 0 percent chance of enactment into law. *H.R. 499: Ending Federal Marijuana Prohibition Act of 2013*, GOVTRACK.US, <http://www.govtrack.us/congress/bills/113/hr499> (last visited Feb. 25, 2014).

153. *I am Congressman Jared Polis, sponsor of HR 499 to allow states to regulate marijuana, former entrepreneur, lead opponent of SOPA/PIPA*, REDDIT (Feb. 12, 2013), http://www.reddit.com/r/IAMACOMMENTS/18err8/i_am_congressman_jared_polis_sponsor_of_hr_499_to/.

bis. The Respect State Marijuana Laws Act of 2013 (H.R. 1523),¹⁵⁴ which was introduced by Congressman Dana Rohrabacher of California on April 12, 2013, and has 19 co-sponsors to date,¹⁵⁵ aims to do just that. H.R. 1523 is a much simpler bill than H.R. 499 and merely amends the Controlled Substances Act by adding the following:

Notwithstanding any other provision of law, the provision of this subchapter related to marihuana shall not apply to any person acting in compliance with State laws relating to the production, possession, distribution, dispensation, administration, or delivery of marihuana.¹⁵⁶

This amendment would have the effect of preventing the application of federal law in those states that have chosen to legalize cannabis, whether for medical and/or recreational purposes. The Respect State Marijuana Laws Act of 2013 has a slightly higher chance of success than H.R. 499, but signs still point to a low likelihood of it becoming a law.¹⁵⁷

B. Executive Branch Action

Given the unlikelihood of congressional action on cannabis, the Executive branch could provide some clarity for the industry through a series of executive-level actions. Since the Executive branch is the sphere of government concerned with executing laws, the President has the authority to direct his government to either enforce or not enforce certain laws. First, the President should insist that his Attorney General clarify the Department of Justice's legal position related to the cannabis industry in those states where cannabis has been legalized. It is clear that the Ogden and Cole Memoranda do not furnish sufficient comfort or knowledge as to what may or may not run afoul of the Controlled Substances Act.

Fortunately, the Department of Justice released a memorandum on August 29, 2013, that attempts to provide some clarity on the conflict of laws.¹⁵⁸ In the memorandum, Deputy Attorney General James M. Cole first outlines the federal government's key priorities with respect to cannabis, including preventing distribution to minors, revenue from the sale of cannabis from benefitting criminal enterprises, cannabis from leaving states where it is legal and entering states where it is not, firearm violence related to cultivation of cannabis, drugged driving, and possession of cannabis on federal property (amongst others).¹⁵⁹ The memorandum explains

154. Respect State Marijuana Law Act of 2013, H.R. 1523, 113th Cong. (2013), available at <http://beta.congress.gov/113/bills/hr1523/BILLS-113hr1523ih.pdf>.

155. *Cosponsors: H.R.1523—113th Congress (2013-2014)*, CONGRESS.GOV, <http://beta.congress.gov/bill/113th-congress/house-bill/1523/cosponsors> (last visited Oct. 27, 2013).

156. H.R. 1523 § 2.

157. GovTrack.us estimates an 8 percent chance of getting past committee and a 2 percent chance of enactment into law. *H.R. 1523: Respect State Marijuana Laws Act of 2013*, GOVTRACK.US, <http://www.govtrack.us/congress/bills/113/hr1523> (last visited Feb. 25, 2014).

158. Memorandum from James M. Cole, Deputy Att'y Gen., U.S. Dep't of Justice to all U.S. Att'ys (Aug. 29, 2013), available at <http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf>.

159. *Id.* at 1-2.

that where state laws and regulatory schemes adequately protect (both on paper and in practice) the federal interests outlined, and where those jurisdictions “demonstrate the willingness to enforce their laws and regulations in a manner that ensures they do not undermine federal enforcement priorities,” then those jurisdictions are “less likely to threaten the federal priorities,”¹⁶⁰ and “enforcement of state law by state and local law enforcement and regulatory bodies should remain the primary means of addressing marijuana-related activity.”¹⁶¹ The memorandum further states that, as federal resources should not be diverted to the regulation of medical cannabis production and use by the seriously ill and their caretakers, neither should they be devoted to those commercial enterprises that are properly regulated in states where cannabis is legal.¹⁶²

Ideally, the Department of Justice would go one step further and issue a memorandum echoing the sentiments of H.R. 1523, thus calling for the federal government to defer fully to the laws of those states where cannabis is legal and clarifying that any other business legally and legitimately doing business within or associated with the cannabis industry will also not be prosecuted. Such a memorandum would have the effect of allowing third-party service providers (e.g., financial institutions) to continue to do business with and bring legitimacy to the industry.

The President should also direct the IRS to issue guidance allowing for those cannabis businesses that are legal within their states of operation to be exempt from Section 280E of the Internal Revenue Code, thereby permitting tax deductions to flow to the business owners of cannabis-related businesses. The President might also require all other agencies that have prohibitions against businesses or individuals involved in the cannabis industry to alleviate those roadblocks in those states where the cannabis industry is legalized (e.g., allowing those prosecuted with cannabis possession charges to be able to purchase firearms).¹⁶³

Executive actions are understandably less ideal than Congressional action due to both the patchwork nature of their implementation and the fact that a new President can dial-back on any of these Executive Actions. However, some reduction of investment risk is preferred to none at all, and would represent a step in the right direction.

160. *Id.* at 2-3.

161. *Id.* at 3.

162. *Id.* (“[P]rosecutors should not consider the size or commercial nature of a marijuana operation alone as a proxy for assessing whether marijuana trafficking implicates the Department’s enforcement priorities. . . . Rather, prosecutors should continue to review marijuana cases on a case-by-case basis and weigh all available information and evidence, including, but not limited to, whether the operation is demonstrably in compliance with a strong and effective state regulatory system.”).

163. See *Quick Reference to Federal Firearms Laws*, U.S. DEP’T OF JUSTICE, www.justice.gov/usao/ut/documents/guncard.pdf (last visited Nov. 18, 2013).

C. State Action

When it comes to mitigating investment risk in the cannabis industry, state regulatory actions will not matter as much without some movement on the federal level. The most significant investment risks existing in the industry are due to the federal regulatory overlay and overall lack of clarity. Nonetheless, states, especially Colorado and Washington, can do a lot to provide comfort for their own industries and a roadmap for other states, if and when they legalize cannabis on the recreational level.

Colorado's Task Force on the Implementation of Amendment 64 released its final report on the regulation of cannabis on March 13, 2013.¹⁶⁴ The report contains approximately 90 pages of recommended rules and regulations for the state to enact, and interested parties are currently providing commentary on those recommendations. One of the key proposals in the report is for the state cannabis industry to have "common ownership from seed to sale. This 'Vertical Integration' model means that cultivation, processing and manufacturing, and retail sales must be a common enterprise under common ownership."¹⁶⁵ This recommendation, which would be the basis for the industry's structure, is deeply flawed, however. Attorney Robert J. Corry, Jr., in his comments to the Task Force, explains:

[C]ommon ownership essentially means that a supermarket would be required to own the apple orchards, cattle ranches, cornfields, wheat fields, orange groves, peanut farms, tomato plants, dairies, etc., any garden or operation that makes produce or products sold on the store shelves, the retailer must own it. There is no other industry in Colorado nor the face of the Earth required to comply with such an irrational and unworkable requirement as common ownership.¹⁶⁶

Such a common ownership structure, with its substantial barriers to entry, would likely create monopolies or oligopolies in the cannabis industry, thereby depriving small businesses of opportunities to partake in the industry and limiting producers' and retailers' freedom to operate. Furthermore, since the Amendment specifically provides for separate licenses (and thus, revenue streams) for retailers, wholesalers, infused manufacturers, and laboratories—the purpose of which was to help these groups develop their expertise and core competencies—the vertical integration model proposed by the Task Force may, among other things, cut potential tax revenue for the state.¹⁶⁷ Other problems raised with the Task Force's recommendations include requirements for separation of inventories for medical and recreational use cannabis,¹⁶⁸ different purchasing limits for

164. See COLO. TASK FORCE REPORT, *supra* note 98.

165. *Id.* at 7.

166. Letter from Robert J. Corry, Jr., to Chairman and Members of the Joint Select Committee on the Implementation of Amendment 64 Task Force Recommendations, Colorado General Assembly, State Capitol 9 (Mar. 20, 2013) [hereinafter Corry Letter], available at <http://www.scribd.com/doc/132229940/Rob-Corry-Amendment-64-Recommendations>.

167. *Id.* at 11.

168. *Id.* at 19.

in-state and out-of-state residents,¹⁶⁹ excessive packaging and labeling requirements,¹⁷⁰ non-independent THC testing laboratories,¹⁷¹ and prohibitions against mixing cannabis with other products (including nicotine and alcohol).¹⁷² Despite its many shortcomings, the Task Force did recognize the pervasive banking issues surrounding the cannabis industry and suggested that the Colorado legislature issue a “joint resolution calling on the federal government to take action by excepting marijuana businesses in states with legalized marijuana industries from relevant federal regulations” or fund a study to consider a way to have a financial institution that is exempt from federal regulation.¹⁷³

Other potential regulations will make Colorado an interesting case study in cannabis industry practices. Proposition AA seeks to implement a 10 percent sales tax (on top of a statewide 2.9 percent sales tax) to cover the costs of regulatory enforcement, as well as a 15 percent excise tax, the proceeds of which would be allocated to public school spending.¹⁷⁴ The Proposition is endorsed by many prominent figures within the state and key editorial boards across the state.¹⁷⁵ In addition to Proposition AA, local jurisdictions also have the ability to impose further taxation on recreational cannabis, as the city of Denver is seeking to do. The result of Denver’s initiative would bring the total tax bill of recreational cannabis in Denver to 38 percent in sales taxes, plus 15 percent in excise taxes.¹⁷⁶ Opponents of these taxing levels argue that they will create “the same incentive for an untaxed unregulated black market as did the original Prohibition.”¹⁷⁷ Proponents of such proposals argue, however, that those tax levels are likely lower than Washington’s taxes on recreational cannabis.¹⁷⁸ Despite any market infrastructure issues, sales and tax revenue from the first month of legal cannabis sales in Colorado were significant.

169. *Id.* at 20.

170. *Id.* at 21-22.

171. *Id.* at 23.

172. Corry Letter, *supra* note 166, at 24.

173. COLO. TASK FORCE REPORT, *supra* note 98, at 98.

174. *What is Prop AA?*, YES ON PROP AA, <http://www.yesonpropaa.com/what-is-prop-aa/> (last visited Nov. 15, 2013).

175. *See Endorsements*, YES ON PROP AA, <http://www.yesonpropaa.com/endorsements/> (last visited Nov. 15, 2013).

176. *See* DENVER ELECTIONS DIVISION, NOTICE OF ELECTION TO INCREASE TAXES/DEBT ON REFERRED MEASURE AND SAMPLE BALLOT (2013), *available at* http://www.denvergov.org/Portals/703/documents/Elections/VoterInfo/Docs/TABORNotice_November2013Coordinated.pdf; *see also* Jacob Sullum, *Will Colorado’s Pot Taxes Preserve the Black Market?*, FORBES (Oct. 10, 2013, 7:30 PM), <http://www.forbes.com/sites/jacobsullum/2013/10/10/will-colorados-pot-taxes-preserve-the-black-market/>.

177. Letter from Robert J. Corry, Jr., Treasurer, “No on Prop AA” Campaign, to Joseph R. Biden, Jr., U.S. Vice President (Sept. 21, 2013), *available at* <http://www.robcorry.com/index.html>.

178. *What is Proposition AA?*, YES ON PROP AA, <http://www.yesonpropaa.com/what-is-prop-aa/> (last visited Nov. 15, 2013).

Colorado collected approximately \$2 million in taxes on \$14 million in retail sales, with \$1.4 million from the recreational cannabis tax and the rest from the state sales tax.¹⁷⁹ The Colorado Department of Revenue “expect[s] clear revenue patterns [to] emerge by April[, after which it can] incorporate this data into future forecasts” to predict cannabis industry tax revenue going forward.¹⁸⁰

Washington’s Liquor Control Board adopted its rules for the regulation of recreational cannabis on October 16, 2013, which became effective on November 16, 2013.¹⁸¹ Fortunately for Washington and the state’s cannabis industry, the biggest flaw of the Colorado approach—the vertical integration model—was affirmatively prohibited from inclusion in I-502.¹⁸² Washington will issue licenses for up to 334 cannabis stores in the state and will limit the number of licenses that any one person can hold to three, in order to prevent monopolies.¹⁸³ Under Washington’s recently enacted rules, growth of cannabis is permitted both indoors and outdoors, provided compliance with specific regulations around each setting; business financiers are required to have three months of Washington state residency and pass criminal background checks; and, medical cannabis retail locations must be separated from recreational cannabis locations.¹⁸⁴ In similar fashion to the heavy cannabis taxation proposed in Colorado, Washington’s rules implement “a 25% sales tax at three different stages: when it’s sold from grower to processor, [from] processor to retailer, and [from] retailer to customer.”¹⁸⁵ Though the effect of these taxes is to increase the price of a gram “from its current average of \$10 closer to \$15,”¹⁸⁶ holding both a producer and processor license permits a business or individual to avoid the 25 percent tax at that stage.¹⁸⁷

179. John Ingold, *Colorado saw \$2 million in recreational marijuana taxes in January*, DENVER POST (Mar. 10, 2014, 3:56 PM), www.denverpost.com/news/ci_25314108/colorado-saw-2-million-recreational-marijuana-taxes-january.

180. *Id.*

181. WASH. STATE LIQUOR CONTROL BD., I-502 IMPLEMENTATION TIMELINE (2013), available at http://www.liq.wa.gov/publications/Marijuana/I-502/I-502-Official_Timeline_10-16-13.pdf.

182. Wash. State Ballot Initiative Measure No. 502 § 5 (July 8, 2011), available at <http://www.liq.wa.gov/publications/Marijuana/I-502/i502.pdf> (“Neither a licensed marijuana producer nor a licensed marijuana processor shall have a direct or indirect financial interest in a licensed marijuana retailer.”).

183. WASH. STATE LIQUOR CONTROL BD., FREQUENTLY ASKED QUESTIONS ABOUT THE I-502 PROPOSED RULES (2013), available at http://www.liq.wa.gov/publications/Marijuana/I-502/proposed_rules/I-502_Proposed_Rules_FAQ2_9-18-13.pdf.

184. *Id.*

185. Jose Pagliery, *Marijuana taxes as a cash cow? Think again*, CNN MONEY (May 10, 2013, 7:00 AM), <http://money.cnn.com/2013/05/10/smallbusiness/marijuana-taxes>.

186. *Id.*

187. See WASH. STATE LIQUOR CONTROL BD., FREQUENTLY ASKED QUESTIONS ABOUT THE I-502 PROPOSED RULES (2013), available at http://www.liq.wa.gov/publications/Marijuana/I-502/proposed_rules/I-502_Proposed_Rules_FAQ2_9-18-13.pdf.

VI. CONCLUSION

This country has a complex history regarding the regulation of cannabis. Despite significant progressive action at the state level regarding legalization of cannabis for medical and/or recreational purposes, the federal government still hangs like a dark cloud over future progress. This cloud has significant and stunting effects on state efforts to develop regulatory regimes that allow businesses and investment in the cannabis industry to thrive legally, which would increase the tax revenue into the state coffers. Formal fund investing, angel investing, and crowdfunding could all be promising means of financing for the cannabis industry; but, until the federal government provides some sort of comfort for investors, these methods of investing will remain constrained. Any executive or congressional action is likely to be met with resistance by entrenched interest groups and politicians, regardless of public support for the legalization of cannabis. However, inroads into the industry have already been made and legal markets are being created. The federal government has a choice of whether to continue spending significant tax dollars on futile regulatory and enforcement efforts or to embrace the change that is occurring as a key partner for the cannabis industry. Or, at the very least, by getting out of its way.